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IN THE

Supreme Court of the United States

October Term, 1969
No. 1036

BAKER COMMODITIES, INC.,

Petitioner,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONER'S REPLY BRIEF.

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PETITIONER'S REPLY BRIEF.

Preliminary Statement.

Petitioner, Baker Commodities, Inc., offers this reply to the Brief for the Respondent in Opposition to petitioner's petition for a writ of certiorari.

ARGUMENT.

I.

Contrary to Respondent's Position, the Question Concerning the Viability of the Kimbell-Diamond Doctrine Presents Appropriate Grounds for Review by This Court.

A. The Petition Presents a Conflict in Reasoning and Result Between the Instant Case and a Recent Decision of the Court of Claims.

In opposition to the petition herein, respondent first attacks petitioner's contention that the reasoning and result of the decisions below conflict with the reasoning and result of the Court of Claims in the case of *American Potash & Chemical Corp. v. United States*, 399 F. 2d 194 (Ct. Cl. 1968), on rehearing 402 F. 2d 1000 (1968).

As we pointed out in the petition, the Court of Claims decided in that case that the stepped-up basis provisions of section 334(b)(2) of the Internal Revenue Code of 1954 did not pre-empt the *Kimbell-Diamond* doctrine.[1] Accordingly, failure to meet the technical requirements of that section was held not to be an automatic bar to a stepped-up basis (measured by cost) when a corporate taxpayer acquires the assets of another corporation by purchasing its stock and then liquidating it. Such reasoning and result are squarely in conflict with the instant case.

Although respondent asserts that there is no conflict with *American Potash*, a careful reading of respondent's

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[1] *Kimbell-Diamond Milling Co. v. Commissioner*, 14 T.C. 74 (1950), aff'd. per curiam 187 F. 2d 718 (5th Cir., 1951), cert. denied 342 U.S. 827, 72 S. Ct. 50, 96 L. Ed. 626.

brief will show that the Government does not really deny that the rationale of the Court of Claims produced a result which is totally inconsistent with the instant case. Rather, the thrust of the Government's argument is that petitioner's reliance on *American Potash* was untimely because it was raised for the first time on petition for rehearing and, therefore, was properly ignored by the Ninth Circuit Court of Appeals. (Br. Resp. Opp. pp. 8-9.)

If, by this, respondent means that there is no conflict because the Ninth Circuit refused to recognize the existence of a contrary authority, so that the opinion below does not disclose the conflict on its face, we submit that respondent is proposing an undue restriction on the type of controversy which warrants review by this Court. Notwithstanding the failure of the Ninth Circuit to comment on the *American Potash* rationale or state any reason for denying the petition for rehearing, it is indisputable that the two decisions cannot be reconciled in principle; both cannot represent correct interpretations of the law. Beyond question, if the instant case were presented to the Court of Claims, petitioner would not have been denied a stepped-up basis under the undisputed facts found by the Tax Court. The alleged noncompliance with section 334(b)(2) would have meant only that petitioner would have received its cost basis by virtue of the principle that the substance of each transaction was a direct purchase of assets (disregarding the intermediate step involving liquidation of the subsidiary), instead of by virtue of the Code provisions dealing with the liquidation of subsidiaries. (See Pet. pp. 11-17.)

B. The Viability of Kimbell-Diamond Presents an Important Question of Federal Law Which Has Not Been but Should Be Settled by This Court.

Even if it could be said that there is no "conflict" within the contemplation of paragraph (a) of Rule 19 of this Court's rules, because the opnion below does not mention the *American Potash* case or its rationale, we submit that the important question raised herein as to the viability of the *Kimbell-Diamond* doctrine justifies a review by this Court under paragraph (b) of Rule 19.

Respondent's brief makes it clear that the Commissioner of Internal Revenue does not agree with the holding in *American Potash* and will argue in future cases that "the *Kimbell-Diamond* doctrine was supplanted by section 334(b)(2) in cases involving acquisitions by corporate taxpayers." (Br. Resp. Opp. pp. 9-10.) As we pointed out in the petition, the *Kimbell-Diamond* type transaction is one of the most commonly used methods whereby one corporation acquires the assets of another corporation. The question of whether or not the *Kimbell-Diamond* doctrine can be applied independently of section 334(b)(2) will certainly have to be faced again. In the meantime, respondent's opposition to *American Potash* will lead to confusion in business planning and the administration of the revenue laws, producing extensive and expensive litigation. The instant case represents a ready opportunity for this Court to review and decide the question now, thereby avoiding those problems.[2]

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[2]Obviously, respondent would prefer to wait for some other case as the vehicle to raise this question. To agree to certiorari in the instant case, would mean acceptance of an obviously unfavor-

Finally, if it is indeed the law that *Kimbell-Diamond* is still viable, the doctrine should be upheld by this Court *in this very case to prevent a manifest injustice to this taxpayer which can be avoided only if the court grants certiorari.* Petitioner has already suffered unfairly from the fact that Congress did not amend section 318 until after the tax years in question. Under the law as amended, the absurd application of the attribution rules which produced the so-called technical failure to comply with section 334(b)(2) relied upon by the Ninth Circuit, is expressly precluded. In other words, petitioner did comply with the technical requirements of section 334(b)(2) as they now exist—and, we submit, as Congress obviously intended them to be from the very beginning.[3] If certiorari is now refused, but the *American Potash* rationale is ultimately upheld in another case, so that even a true technical non-compliance should not have prevented the stepped-up basis, it will compound the incredible miscarriage of justice perpetrated upon this petitioner.

C. Petitioner's Reliance on American Potash Was Timely.

With respect to the question of timeliness, we submit that respondent's argument is simply an attempt to avoid facing this important issue, which goes to the

able fact situation from the Government's standpoint, in that the alleged technical non-compliance with section 334(b)(2) had no substantive effect on the transaction. It is difficult to conceive of a clearer situation wherein the subjective intent necessary for *Kimbell-Diamond* to apply could be present. Moreover, respondent is understandably reluctant to risk the loss of the large deficiency which it has already won in this case.

[3]See the reasons stated for elimination of multiple reattribution in 2 U.S. Code Cong. & Adm. News '64, p. 3401, Senate Committee Report on P. L. 88-554. (Reprinted in part in Appendix D, Pet. App. pp. 88-89.)

very heart of the controversy over whether or not petitioner was entitled to the stepped-up basis. Indeed, throughout this case, respondent has repeatedly relied on technical arguments without offering any reasons why the result sought was just or in accordance with the real objectives of the revenue laws involved.

Furthermore, petitioner denies that its reliance on *American Potash* was untimely. That case was not decided until July 17, 1968, more than a year after the Tax Court decision in the instant case. As we pointed out in the petition for rehearing to the Court of Appeals:

> "We recognize that this argument is being raised for the first time in this proceeding. However, we did not have the benefit of the *American Potash* case when the matter was decided by the Tax Court; and the report of the Court of Claims' decision had only reached the advance sheet stage by the time our appellate briefs were filed and we were unaware of it. In any event, it is certainly not too late to raise the point. One of the purposes of the Rehearing procedure is to permit parties to call to the Court's attention recent developments in the law which were not considered in the briefs or in the Court's opinion, and which have a material bearing on the proper disposition of the matter. Unquestionably, under these circumstances, substantial justice requires that this question can be considered by the Court. To refuse would merely add one more technical justification for an unconscionable tax result which may well cause the financial ruin of this appellant." (Pet. App. E, pp. 92-93.)

It is submitted that in principle, this situation is analogous to one where an authority relied upon by a court in reaching its decision has been reversed and the reversal is called to the court's attention by a petition for rehearing. In such case, the decision relying on the reversed authority is erroneous and should be vacated on rehearing, or at least modified and placed on some other legitimate ground. See, *Brenna, et al. v. Federal Cartridge Corporation,* 183 F. 2d 414 (8th Cir. 1950). As we stated above, this is one of the purposes for the rehearing procedure. So long as the petition for rehearing is itself timely (as it was here), the court's decision is not yet final. If it is wrong, it should be corrected.

The authorities relied upon by respondent to justify the Ninth Circuit's refusal to consider *American Potash* on rehearing are plainly distinguishable and inapplicable. In *Stephens v. Arrow Lumber Co.,* 354 F. 2d 732 (9th Cir. 1966), an appellant attempted to raise for the first time on appeal a new and inconsistent claim which could have been presented to the trial court. Similarly, in *Mitchell v. Greenough,* 100 F. 2d 1006 (9th Cir. 1939), the losing party on appeal attempted on petition for rehearing to rely on a three-year statute of limitations rather than the two-year statute which had been held applicable by the court. The critical difference in both of these cases is that the party attempting to raise the new and different issue was not relying on any new cases or developments in the law having an undeniable and material impact on the issues before the court, as is true here. Indeed, in the *Mitchell* case the court expressly pointed out as an alternative ground for denying the petition for rehearing that the different statute

of limitations urged by the petitioner (which had been in existence all the time) would not have changed the court's ultimate decision on the merits.

In the instant case, petitioner did not attempt to "shift" to an inconsistent or totally new and different position which would require the court to reconsider the case *in toto*. The essential issue in the case was whether the Commissioner of Internal Revenue improperly denied petitioner a stepped-up basis. However, everyone, including the parties and the courts, were under the impression that a stepped-up basis in a *Kimbell-Diamond* transaction could only be allowed through technical compliance with section 334(b)(2). The Tax Court, in fact, expressly discussed the *Kimbell-Diamond* doctrine and suggested that the technical requirements in section 334(b)(2), as the statutory embodiment of that doctrine, were "an attempt to limit the availability of the stepped-up basis." (Pet. App. B, pp. 65-66.) Of course, petitioner contended, and still contends, that those technical requirements were complied with. The point is, petitioner was not changing its position or raising a totally unrelated new issue when it discovered the *American Potash* decision and urged it to the Ninth Circuit. Petitioner was simply pointing out that under a newly discovered recent interpretation of the law the Tax Court's belief that technical compliance with section 334(b)(2) was the exclusive method of obtaining a stepped-up basis was no longer correct and should not have been affirmed.

Respondent argues that a holding that the *Kimbell-Diamond* doctrine is still viable would not finally dispose of the case and that a new trial would be necessary. Such contention has no merit for two reasons: First, the court's proper function is not to dispose of cases as

quickly as they can be decided, regardless of whether justice is served. Where the court has decided a case on erroneous grounds, it should not be permitted to stand on that decision for the sake of mere expedience. If justice requires a rehearing, or even a remand to the trial court for further proceedings, it is the court's duty to take such action.

Secondly, a complete new trial certainly would not be necessary here. Indeed, we submit that no further evidence at all is needed and the most that could be required of the Tax Court would be to make a finding as to whether or not petitioner purchased the stock of the three corporations in question for the purpose of acquiring their assets. Actually, we believe the findings already made by the Tax Court conclusively establish such intent by necessary implication. In any event, the indisputable facts that the price was based primarily on appraisals of the assets, and the corporations were liquidated immediately, provide ample basis for the appellate court to assume that the necessary intent would have been found by the Tax Court on remand.[4]

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[4]This situation should be contrasted with *American Potash* where the facts did not indicate so clearly the existence of the subjective intent to acquire assets. (The subsidiary corporation was operated for a period of seven months before liquidation.) For that reason, the case had to be remanded for further proceedings.

We wish to point out also that respondent missed the point in arguing that because of the remand in *American Potash*, there is "no final 1954 decision permitting a corporate taxpayer like petitioner to step up its basis in the assets of a liquidated subsidiary where it has failed to comply with the conditions prescribed in section 334(b)(2)." The real significance of the *American Potash* case does not depend on whether or not the taxpayer ultimately prevails on the facts. The point is that it does represent an appellate level final decision that the *Kimbell-Diamond* doctrine is viable and can be applied independently of section 334(b)(2).

II.

The Petition Presents Important Questions Concerning Mutliple Stock Attribution and the Interrelationship of Sections 318 and 334(b)(2), Which Were Not Disposed of by the 1964 Amendment to Section 318.

Respondent suggests that no proper question for review by this Court is raised with respect to multiple stock attribution because petitioner concedes that this is a case of first impression on that subject, and because "the result reached below" is no longer possible in view of the 1964 amendment to section 318. In so arguing, respondent has grossly over-simplified the questions which the petition presents.

To begin with, it is certainly no bar to certiorari that the matter raised is one of first impression. Under Rule 19(b) of the rules of this Court, important questions of federal law may be settled by this Court even though there is no conflict in the decisions of the lower courts.

As for the 1964 amendment to section 318, it is true that the extreme and extraordinary result reached below is no longer possible (leaving petitioner as the only known taxpayer to suffer from Congress' original mistake). But the amendment only eliminated multiple reattribution of the same stock, from a partner to his partnership and out to another partner (in this case it was even reattributed to a second separate partnership in which the actual owner of the stock had absolutely no interest). The amendment in no way affects the result of this case insofar as it holds that a purchase intended to comply with section 334(b)(2) can be dis-

qualified as a non-arm's length acquisition under section 334(b)(3)(C), solely by virtue of *constructive* ownership—worse yet, constructive ownership created by combining stock attributed from *diverse and unrelated sources.* (We respectfully refer the Court again to the discussion of these points in the petition, at pp. 23-26.)

It is our contention that the clear intent of Congress in adopting section 334(b)(3)(C), with its reference to section 318, was to deny the important benefits of section 334(b)(2) to corporations which buy the stock of another corporation from their own controlling stockholder. In order to be a "person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock," as used in section 334(b)(3)(C), the seller must own 50% or more of the acquiring corporation, thereby activating the rule of shareholder-corporate attribution. But did Congress also intend that such fatal 50% ownership of the acquiring corporation could itself be created constructively in the seller by applying other attribution rules, such as partnership attribution from a partnership having no business connection with the acquiring or acquired corporations? We strongly urged that the artificial control thus created for the seller—particularly where actual control is shown not to exist—cannot be justified as a basis for applying section 334(b)(3)(C), in light of the objectives of the statute. Yet, that result is still possible, and indeed is *required*, under the construction of the statutes adopted by the courts below.

Respondent does not offer any reasons why such result is either just or consistent with Congressional objectives. We submit there are none. It is no answer to this argument to simply say, as respondent does, that

Congress meant what it said, or to counter that petitioner "cites no authority for its assertion." (Br. Resp. Opp. p. 11.) Surely, the courts can determine Congressional intent and the underlying objective of the statutes in question by applying logic and common sense. They should be construed in accordance with that intent and objective.

The final point we wish to make on this question is that respondent is totally in error when it states, in footnote 5 of its brief, on page 11, that throughout these proceedings the Jeromes as individuals and the Jerome Brothers Partnership have been treated as interchangeable, and that at no time did petitioner question such treatment. Respondent offers this statement in answer to the point raised in the petition that the courts below failed to distinguish the 1962 Veronica stock purchase, which was from the three brothers as individuals, from the 1961 transaction wherein the stock was purchased from the Jerome Brothers Partnership. The significance of this is that in no event should the Veronica transaction have resulted in the loss of a stepped-up basis, because ownership interests of separate sellers—even brothers—cannot be combined for purposes of applying sections 318 and 334(b)(3)(C).

Contrary to respondent's contention that this point was never made below, we quote the following paragraph from our opening Brief for Appellant to the Court of Appeals (at p. 53, n. 15):

> "With respect to the 1962 transaction, another fiction was also employed. The Veronica stock was acquired from the Jeromes as *individuals* and could not be attributed to appellant except in a roundabout fashion through attribution to the Jerome

> Brothers partnership. This is because no individual Jerome had as much as 50% of appellant's stock and their separate ownership could not be combined for Section 318 purposes. *Stevens Pass, Inc., supra,* at 539, n. 5 (dictum)."[5]

At all times, in stating the facts to both lower courts, petitioner was careful to point out this difference in ownership between the 1961 and 1962 transactions. (See, also, p. 13 and p. 14, n. 4 of petitioner's opening brief to the Court of Appeals.) The Tax Court itself, in its findings of fact, correctly stated that the stock was owned by and acquired from the Jerome brothers as individuals. (Pet. App. B. pp. 47-50.) The Court of Appeals also observed the distinction in stating the facts. (Pet. App. A. p. 6.) Never, at any time, did either of the lower courts ever state directly or indirectly that the three Jeromes and their partnership were interchangeable for tax purposes, or that their separateness should be disregarded in any way. The courts simply failed to consider the significance of such separate status when they reached their legal conclusions.

III.

The Question of Partnership Termination for Purposes of Applying the Stock Attribution Rules Raises Appropriate Grounds for Certiorari.

Petitioner contends that the holding of the lower courts concerning the viability of Manchester partnership raised two appropriate grounds for review by this Court. First, there is the important question not yet decided by this Court as to when a partnership

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[5]48 T.C. 532 (1967).

ceases to exist as such for tax purposes, and particularly for section 318 purposes. Secondly, the decision of the Court of Appeals is in conflict with other appellate decisions cited in the Petition.

Respondent argues that the lower courts were correct in holding that Manchester remained in existence past December of 1962, since "none of its partners had withdrawn, its affairs had not yet been wound up and it had not been dissolved under applicable California law." (Br. Resp. Opp. p. 11.) Respondent is merely compounding the errors made by the lower courts with respect to California law. The March 1, 1961 sale of Manchester's entire business asserts and cessation of business definitely was a dissolution under California law for the unanswered reasons which are stated in the petition. Furthermore, the Court of Appeals did not really dispute that there was a dissolution; the disagreement with petitioner's position involved the effect of a dissolution on the agency relationship between partners and partnership, and the relevance of such relationship to stock attribution through a partnership under section 318. (See, Pet. pp. 20-23.)

Respondent contends that Manchester's existence or non-existence should be determined by reference to section 7701(a) of the Internal Revenue Code, rather than section 708. Section 7701 merely provides the definition of a partnership and offers little help as to when a partnership *terminates*. For that reason, we looked to section 708 for guidance, and we submit that respond-

ent has totally failed to meet our arguments. (See Pet. pp. 17-20.) But even the language of section 7701(a) supports petitioner's position, since the definition of a partnership plainly requires that a business be carried on. Here, all business activity ceased after the sale of Manchester's assets. The only activity of any kind was the collection of the sale price of the assets, which surely does not fall within the language of section 7701. (Pet. App. B. pp. 43-45.)

Respondent attempts to brush aside the conflict in principle between the instant case and three other appellate decisions (including two from other circuits) on the apparent ground that they did not specifically involve a partnership termination for section 318 purposes. The conflict in rationale is no less significant because section 318 was not involved in those cases. If a partnership terminates for other tax purposes on the sale of all its assets, as in those cases, on what basis can it be said to remain in existence for section 318 purposes?

In closing, we wish to point out again that neither the lower courts nor respondent have ever offered a single reason why the objectives of section 318 justify an interpretation which makes a partnership remain viable for stock attribution purposes in a subsequent unrelated transaction after it has sold all of its assets and ceased all business, has dissolved under state law terminating the agency relationship between partners as

to new matters, and has no existence for any purpose except to "wind up its affairs" by collecting the sale price.

Conclusion.

For the reasons stated herein and in the petition, it is submitted that a writ of certiorari should be granted.

Respectfully submitted,

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